IN THE

# Supreme Court of the United States

OCTOBER TERM, 1941

NATIONAL MANUFACTURE AND STORES CORPORATION,
*Petitioner,*

v.

MARION H. ALLEN, COLLECTOR OF INTERNAL REVENUE,
*Respondent.*

No. 1091

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

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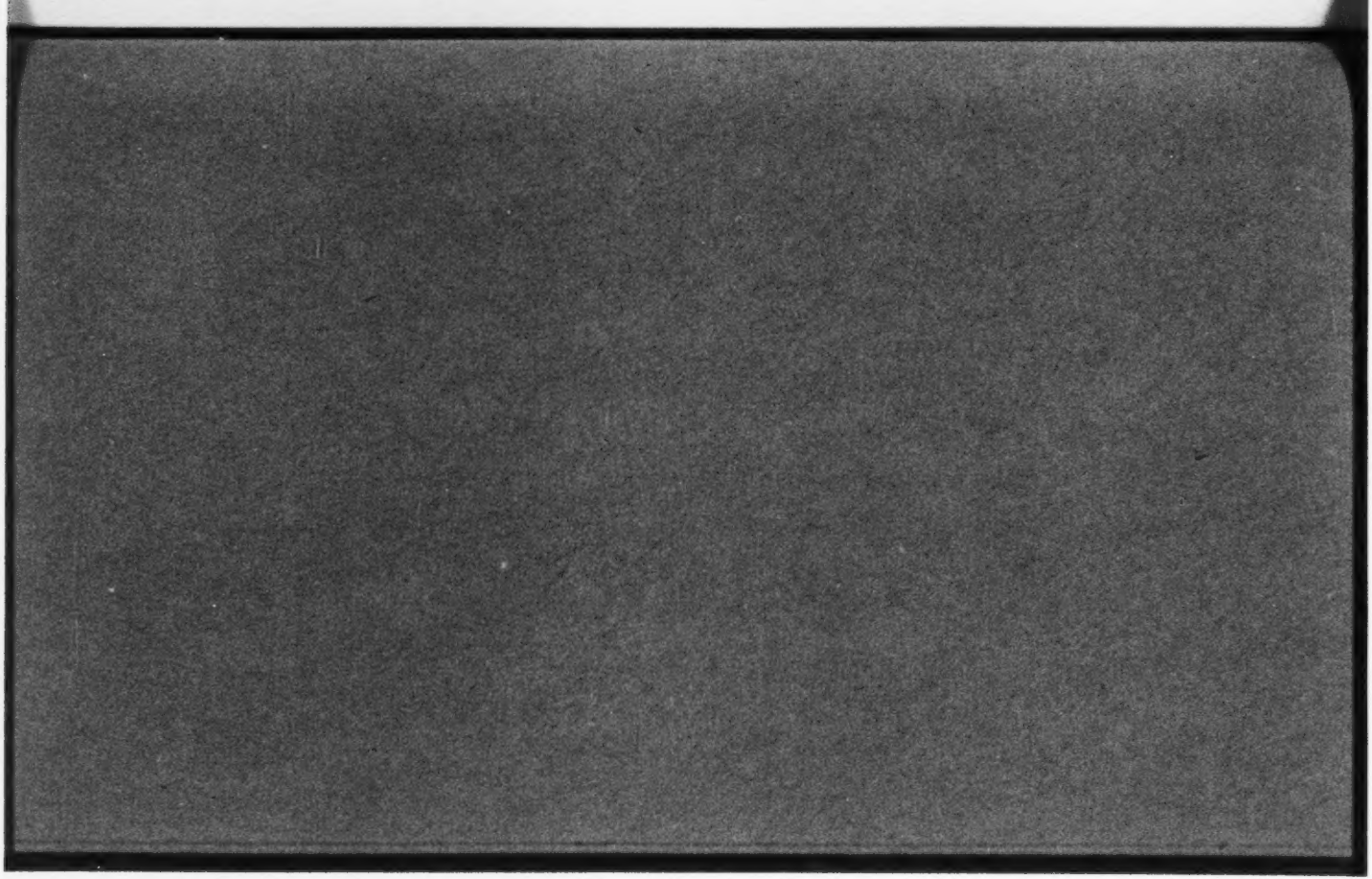

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## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner respectfully petitions for a writ of certiorari to review a judgment of the Circuit Court of Appeals for the Fifth Circuit, and for reason therefor respectfully shows the following:

## JUDGMENT AND OPINION BELOW

The judgment sought to be reviewed was entered January 28, 1942, by the Circuit Court of Appeals for the Fifth Circuit in the case of Marion H. Allen, Collector of Internal Revenue v. the case of Marion H. Allen, Collector of Internal Revenue v. National Manufacture and Stores Corporation. (R. 47) The opinion of the Circuit Court of Appeals commences on page 39 of the Record, and the dissenting opinion on page 44.

The judgment of the Circuit Court of Appeals reversed a judgment of the District Court of the United States for the Middle District of Georgia in favor of the petitioner, taxpayer. (R. 31) The findings of the District Court commence on page 27 of the Record and the opinion of the District Court on page 32.

## STATUTE AND REGULATION INVOLVED

The Revenue Act of 1936 is involved and the controversy turns upon the construction of Section 22(a), as follows:

> "(a) GENERAL DEFINITION—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

The Treasury Regulation involved is Treasury Decision 4430, dated May 2, 1934, as follows:

> "Acquisition or disposition by a corporation of its own capital stock.—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
>
> "But, if a corporation deals in its own shares as it

might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Act."

## QUESTION PRESENTED

Under Section 22(a) of the Revenue Act of 1936, with respect to shares of its own capital stock purchased for retirement, did petitioner realize taxable income upon a sale by it of such shares for an amount in excess of the price paid by it for such shares?

It is petitioner's contention: (1) That it realized no income by virtue of such transaction, and; (2) that even if income were realized, such income was not taxable under the Revenue Act of 1936, Section 22(a).

## REASONS RELIED ON FOR ALLOWANCE OF WRIT

The question presented is of great importance since it involves the administration of the Revenue laws of the United States in respect of transactions occurring repeatedly and frequently throughout the United States.

A direct conflict exists between the Fifth Circuit Court of Appeals in its opinion in this case, and the Second Circuit Court of Appeals in the case of *E. R. Squibb & Sons v. Commissioner of Internal Revenue*, 98 *Fed.* (2*d*) 69. Both cases involve the question whether or not the excess over the cost

price received by a corporation in the sale of its own shares of stock is taxable income. The Second Circuit in the Squibb case holds that there is no taxable income where the shares are sold at a price in excess of their cost but not in excess of their value at the time of sale. The Fifth Circuit in its opinion in the present case holds that taxable income is received upon a sale of shares in excess of the cost thereof.

The Supreme Court in *Helvering v. Reynolds Company*, 306 *U. S.* 110, dealing with the definition of "gross income" in the Revenue Act of 1928, held that by virtue of successive reenactments of the Revenue laws between 1913 to and including 1932 with no change in the provision of the law, that Congress was deemed to have adopted the construction given to the statute by the Treasury Regulations during these fifteen years.

Thus, the Court held that under the Revenue Act of 1932 a corporation derived no gain or loss upon the purchase and sale by it of its own stock. This was in accordance with the interpretation of the statute by the Treasury Regulations which this Court said had through many successive reenactments of the statute become imbedded in the statute itself.

No change in the definition of "gross income" was made in the enactment of the Revenue Act of 1934, Sec. 22(a).

The Section (22(a)) was reenacted exactly in the same language in the Revenue Act of 1936.

However, the Treasury Department on May 2, 1934, just two days before the enactment of the Revenue Act of 1934, by Treasury Decision 4430 changed the regulations with respect to purchase and sales by a corporation of shares of its own stock. This Treasury decision is hereinabove quoted in full.

It is petitioner's position that the law in respect of such transactions could not be changed by Treasury Regulations, and that

if T. D. 4430 be construed to change the law, that the said T. D. 4430 is invalid.

The said Treasury Decision 4430 was either called to the attention of Congress or it was not. If it was not called to the attention of Congress it had no effect upon the intention of Congress. If it was called to the attention of Congress then Congress by reenacting the statute in the same language with knowledge that its meaning had been administratively settled and judicially settled by the decision in *Helvering v. Reynolds Company, supra,* instead of adopting the construction shown by the new Regulation, in effect repudiated it and adhered to the former Regulation which had come to have the force of law.

If the Treasury Department can merely by changing Regulations effect a change in the substantive law with respect to a statute which has been construed by the Supreme Court as having a definite meaning, and can make this change without any change in the statute itself and without any action on the part of Congress, then the power of Congress to legislate is relegated to a veto power only.

It is most important to the Treasury Department and to taxpayers alike that the power asserted by the Treasury Department to so legislate be judicially settled and determined.

## STATEMENT OF CASE

There is no dispute as to the facts. (R. 40)

Petitioner is engaged in the business of selling merchandise on the installment plan.

In 1929 petitioner adopted the policy of buying in its stock for the purpose of retiring it whenever its stock could be acquired at less than its market value. (R. 18, 28)

Pursuant to this policy, over a period of time it bought

11,553 shares of its stock, which it cancelled and retired. (R. 19)

In 1930 and 1931 it bought an additional 6900 shares of its stock with the purpose and intention of cancelling and retiring it. (R. 17, 19, 28) However, with the coming of the depression, petitioner did not have enough available cash to pay for the 6900 shares. (R. 18, 29) Under these circumstances, it made an agreement with Hayden, Stone & Company, brokers, under which the brokers accepted 50% of the purchase price and carried the stock for the balance of the purchase price. (R. 18, 24, 29) The stock was carried on petitioner's books as treasury stock at a nominal figure of $1. (R. 18, 29)

Finally, as a result of petitioner's needs for cash for working capital, and of a demand by Hayden, Stone & Company for payment, petitioner sold the 6900 shares of stock on March 15, 1937, at $10 a share, the total amount received being in excess of the cost by $24,875.65. (R. 19, 24, 28, 29) This was the only treasury stock which the company ever sold. (R. 19) The amount received was, however, less than the intrinsic value or market value of the stock at that time. (R. 22, 30)

Income tax was paid by the petitioner on this excess, after which a claim for refund was filed, and receiving no action on the claim, this suit was filed. (R. 28)

## CERTIFICATION OF ERRORS

The Circuit Court of Appeals erred in ruling:

(1) That petitioner derived income on the sale of its own shares of stock;

(2) That under Section 22(a) of the Revenue Act of 1936 petitioner was taxable on such income;

(3) That the amendment of May 2, 1934, to the Treasury Regulations by T. D. 4430 was effective, upon

enactment of the Revenue Acts of 1934 and 1936, to change the law as annunciated by the Supreme Court in *Helvering v. Reynolds*, 306 *U. S.* 110, without any change in the statute itself.

(4) That petitioner dealt in its own shares as it might have dealt in shares of another corporation.

## CONCLUSION

For the reasons stated, and to resolve the conflict in the opinions of the Second and Fifth Circuits, it is respectfully urged that the writ of certiorari be granted.

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## BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

## JURISDICTION

The jurisdiction of the Court is based on Section 240 of the Judicial Code as amended by the Act of February 13, 1925 (Title 28 USCA Section 347).

## HISTORY OF REGULATIONS AND STATUTES DEALING WITH SALES BY CORPORATIONS OF OWN STOCK

From 1920 to May 2, 1934, the successive Regulations of the Treasury Department contained the following with respect to transactions by a corporation in its own stock:

> "SALE BY CORPORATION OF ITS CAPITAL STOCK —* * * or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A CORPORATION REALIZES NO GAIN OR LOSS FROM THE PURCHASE OR SALE OF ITS OWN STOCK."
>
> (Emphasis ours)
>
> *Art.* 543 *of Regulations* 45, 62, 65, 69;
>
> *Art.* 66 *of Regulations* 74, 77.

During this time there were five successive reenactments of the income tax laws with no change in the definition of "gross income."

Thus this Court in *Helvering v. R. J. Reynolds Tobacco Company, supra,* held that the continued and successive reenactments by Congress of the income tax statute was effective to adopt the departmental interpretation on this subject as shown

by the above Regulations, and that, consequently, the sale by a company of treasury stock at an excess over the cost to it of the stock was not taxable income as to a transaction in 1928.

On May 2, 1934, the Treasury Department by T. D. 4430, set out in full in the foregoing petition for certiorari, amended its Regulations. The Revenue Act of 1934 was enacted into law two days after the promulgation of Treasury Decision 4430. In 1936 the Revenue Act of 1936 was adopted. In both the Revenue Act of 1934 and the Revenue Act of 1936 no change was made in the definition of "gross income."

Throughout the Revenue Acts from the year 1921 through 1936 the definition of "gross income" in so far as here pertinent has remained unchanged. It is as follows:

> "(a) GENERAL DEFINITION—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *" (Sec. 22(a) Rev. Act 1936)

## CONFLICT BETWEEN CIRCUITS

The decision of the Fifth Circuit in the present case is in direct conflict with the decision of the Second Circuit in the case of *E. R. Squibb & Sons v. Helvering*, 98 *Fed.* (2*d*) 69, in which the Court held that a corporation does not derive taxable income from the sale of its own shares previously acquired as treasury stock where the sale is in excess of the cost of the stock, but not in excess of the value of the stock. To the same effect is *Johnson v. Commissioner*, 56 *Fed.* (2*d*) 58, decided by the

Fifth Circuit, and *National Home Owners Service Corporation v. Commissioner*, 39 *BTA* 753, decided under the Revenue Act of 1934. Indeed, the effect of the decision in the present case is to create a conflict within the Fifth Circuit itself, in view of the *Johnson* decision, *supra*.

Petitioner's counsel are advised that there are a number of appeals pending before the United States Board of Tax Appeals involving the same question here involved.

## Securities and Exchange Commission, Accounting Profession and New York Stock Exchange Experts Agree No Gain Derived by Corporation on Sale of Its Own Treasury Stock.

The Securities and Exchange Commission has ruled on this precise question as follows:

> "* * * from an accounting standpoint, there appears to be no significant difference in the final effect upon the company between (1) the reacquisition and resale of a company's own common stock and (2) the reacquisition and retirement of such stock together with the subsequent issuance of stock of the same class."
>
> "It is recognized that when capital stock is reacquired and retired any surplus arising therefrom is capital and should be accounted for as such and that the full proceeds of any subsequent issue should also be treated as capital. Transactions of this nature do not result in corporate profits or in earned surplus. There would seem to be no logical reason why surplus arising from the reacquisition of the company's stock, and its subsequent resale should not also be treated as capital."
>
> *S. E. C. Accounting Series, Release No. 6.*

A Special Committee of the American Institute of Accountants on Cooperation with Stock Exchanges, has reached the same position:

"Your committee believes that while the net asset value of the shares of common stock outstanding in the hands of the public may be increased or decreased by such purchase and retirement, such transactions relate to the capital of the corporation and do not give rise to corporate profits and losses. Your committee can see no essential difference between (a) the purchase and retirement of a corporation's own common stock and the subsequent issue of common shares, and (b) the purchase and resale of its own common stock."

65 *Journal of Accountancy*, 1938, *p.* 417.

The Executive Committee of the American Accounting Association has reached the same result.

"The income account of a corporation should not include credits or charges resulting from profits or losses on transactions involving the issuance, purchase, or retirement of its own stock. * * * Paid-in capital consists of amounts received for shares issued: capital stock, paid-in surplus, gains from the sale of reacquired shares and from the retirement of re-acquired shares purchased at a discount. * * * Earned surplus should include no credits from transactions in the company's own stock. * * *"

11 *Accounting Review*, 1936, *p.* 187.

Thus there is absolutely no difference from a factual standpoint in the following two cases:

*Case* 1. Corporation A purchases for $100 per share 100 shares of its stock for retirement and retires it. It then issues 100 new shares of stock which it sells for $150 per share. The Treasury Department recognizes that there is no gain or loss on this transaction.

*Case* 2. Corporation A purchases for $100 per share 100 shares of its stock for retirement, but instead of retiring the stock it sells the stock for $150 a share.

There is absolutely no difference in effect in the second illus-

tration from the first. The corporation ends up with exactly the same number of shares outstanding, exactly the same capital liability, exactly the same cash position and all stockholders have exactly the same position and interest as in the first case, yet the Treasury Department contends that the second transaction is taxable and the first is not.

Surely the Court must look through form and give effect to substance. *Minnesota Tea Co. v. Helvering*, 302 *U. S.* 609.

## TREASURY STOCK IS NOT OUTSTANDING

The Second Circuit in *Borg v. International Silver Company*, 11 *Fed.* (2*d*) 147, concludes that —

> "Treasury stock is not 'outstanding'; such stock not being effective obligation against corporation."

### 1934 Amendment to Treasury Regulation T. D. 4430 Not Intended to Affect Type Transaction Here Involved or Change Rule of Law Existing Under Prior Regulations.

If possible Treasury Decision 4430 should be construed as to uphold its validity.

That the amended Regulation (T. D. 4430) was aimed at ordinary commercial transactions and not at a capital transaction as here involved was the view of the Fifth Circuit in the case of *Dorsey v. Commissioner*, 76 *Fed.* (2*d*) 339. That decision written by Judge Sibley some time after the amendment to the Regulations clearly indicates the view of this Court on this subject. It was there stated:

> "The point of law dealt with by the Board is whether the transaction was controlled by the last sentence of Regulation 74, Art. 66: 'A corporation realizes no gain or loss from the purchase or sale of its own stock.' A reading of the whole Regulation, which had existed at least since

1918, shows that it referred mainly to the original sale of the capital stock and to stock turned back by stockholders to be resold to raise more capital. It was amended in 1934 by T. D. 4430 to distinguish clearly between original capital transactions and ordinary commercial dealings in its own stock as in that of another corporation. * * *"

Indeed, the above decision of the Fifth Circuit creates even more confusion in this Circuit.

The type of transactions embraced within T. D. 4430 are dealt with in the following cases:

*G.C.M. p.* 107,

*Cumulative Bulletin Treas. Dept. X*3-1.

*S. A. Woods Machine Co. v. Commissioner*, 57 *Fed.* (2*d*) 635.

*Boca Ceiga Development Co. v. Commissioner*, 66 *Fed.* (2*d*) 1004.

*Walville Lumber Co. v. Commissioner*, 35 *Fed.* (2*d*) 445.

*Spear & Co. v. Heiner*, 54 *Fed.* (2*d*) 134.

## 1934 Amendment by T. D. 4430 Invalid in so far as It Purports to Change Law.

In *E. R. Squibb & Sons v. Helvering, supra*, the Court accepted this exact view, stating as follows:

"But in any event it seems to us that the uniform interpretation, so long placed upon paragraph 22(a), 26 U. S. C. A. paragraph 22(a), by the regulation and confirmed by the inaction of Congress, was imbedded in the statute so deep that only legislation could dislodge it."

That the Treasury Department has no power to make or change laws, by Regulation or otherwise, is well settled.

*Morrill, Collector v. Jones*, 106 *U. S.* 466.

*Waite v. Macy*, 246 *U. S.* 606.

*Miller v. U. S.*, 294 *U. S.* 435.

"While administrative regulations may interpret and fill in details of an internal revenue statute, such regulations may not amend the statute or alter the meaning which Congress intended that the statute should have."

*Commissioner of Internal Revenue v. Warren Webster Trust No. 1 et al.*, (*Third Circuit*) 122 *Fed.* (2*d*) 915 (*Headnote* 5).

**If the Amended Regulation Was Effective to Change the Law the Change Is Not Applicable to the Transaction Here Involved Because Petitioner Was Not Dealing in Its Own Shares in a Speculative Manner or As It Might Have Dealt in the Shares of Another Corporation.**

From the undisputed evidence in this case it is perfectly obvious that petitioner was not speculating in its own stock and was not trading in its own stock as it might have traded in other stocks. The transaction involving the purchase of this stock was undertaken with the specific intention of retiring the stock. When the stock was later sold, it was done for the purpose of raising capital. Therefore, even if the Court should reach the conclusion that the law with respect to a corporation's buying and selling its own stock was changed by T. D. 4430, it is perfectly clear that the transaction involving petitioner does not come within the scope of the change in the Regulation.

Respectfully submitted,

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